

Fiscal Services Division

Legislative Services Agency

Fiscal Note

SF 128 - Cigarette/Tobacco Tax Increases (LSB 1023 SV)

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Fiscal Note Version - New

Description

Senate File 128 increases the cigarette tax rate from \$0.36 per pack of 20 cigarettes to \$1.36 per pack and increases the tobacco tax rate from 22.0% of the wholesale cost to 44.0% of the wholesale cost. The Bill also creates a Health Care Trust Fund in which the cigarette and tobacco tax revenues will be deposited.

Background

The cigarette tax was last increased in 1991 when it was raised from \$0.31 per pack to the current rate of \$0.36 per pack. The tobacco tax was also increased that year, moving from 19.0% to 22.0% of the wholesale price.

Under current law, the Revenue Estimating Conference projects gross cigarette tax revenues to be \$89.5 million in FY 2008 and \$90.4 million in FY 2009. Gross tobacco tax receipts are projected to be \$9.7 million in FY 2008 and \$10.0 million in FY 2009.

Assumptions

Cigarette Tax:

- The retail price of a pack of cigarettes is \$3.64.
- Iowa currently loses about 8.8% of cigarette tax revenue due to various types of evasion. The rate of tax evasion following the rate change is assumed to equal 18.35%.
- Based on research, a \$1.00 per pack (27.5%) increase in price has an elasticity equal to negative 0.7. Overall demand due to the tax increase is estimated to decrease by 19.2%.
- Preemptive buying equal to 21.5% of normal purchases is assumed to occur over the month and a half preceding the rate change and offsetting reductions in purchases are spread over six months following the rate change.
- The assumed effective date for the rate change is April 1, 2007.
- Fiscal Year 2009 cigarette demand is assumed to decline by 1.0% from the previous year (prior to the tax change).
- The increase in the cost of cigarettes will have a higher negative impact on the sale of cigarettes in Iowa border communities.

Tobacco Tax:

- Assumes the same assumptions used for cigarettes in regards to tax evasion and early purchasing rates due to an increase in tax.
- A retail margin of 20.0% over the wholesale price is assumed for tobacco products (other than cigarettes).

- The demand price elasticity assumed for a tax rate change from 22.0% to 44.0% of the wholesale price (equivalent to a 21.1% retail price increase) equals negative 0.585. Overall demand due to the tax increase is estimated to decrease 10.5%.
- The assumed effective date for the rate change is April 1, 2007.

Sales Tax (State, Local Option Sales Tax (LOST), and School Infrastructure Local Option Sales Tax (SILO):

- Due to the cigarette/tobacco tax increase, demand is estimated to decrease nearly 20.0% from the pre-tax increase projections. However, the overall sales taxable cost of the products is increasing, offsetting much of the decreased demand.
- Tax evasion is estimated at 8.8%.
- Statewide, the percent of local option sales tax (LOST) is assumed to remain at the FY 2006 level of 0.69% and the School Infrastructure Local Option Sales Tax (SILO) is assumed to remain at 0.95%.

FY 2007 General Fund and Health Care Trust Fund:

- Cigarette and Tobacco tax receipts will be deposited in the Health Care Trust Fund beginning April 1, 2007. It is assumed that based on current projections, 73.0% of the projected REC cigarette tax estimate plus the additional cigarette tax revenue due to the higher demand prior to the tax increase will have been deposited in the General Fund. Similarly, approximately 71.0% of the projected REC tobacco tax estimate plus the additional tobacco tax revenue due to the higher demand prior to the tax increase will have been deposited in the General Fund.

Section 1 of SF 128 increases the minimum amount a retailer can charge for cigarettes from 6.0% to 8.0% of the basic cost of cigarettes. Section 2 increases the minimum amount a wholesaler can charge for cigarettes from 3.0% to 4.0% of the basic cost of cigarettes. Although these sections may have an impact on State sales tax, local option sales tax (LOST), and school infrastructure local option sales tax (SILO), that amount is unknown and not addressed in this fiscal note.

Fiscal Impact

Because the tax revenues from the cigarette tax and tobacco tax will be deposited in the Health Care Trust Fund, there will be a decrease to the General Fund from current estimated Revenue Estimating Conference projections.

Cigarette Tax Impact:

Receipts from the cigarette tax will be split between the General Fund and the Health Care Trust Fund in FY 2007. In FY 2008 and FY 2009, all cigarette tax receipts will be deposited in the Health Care Trust Fund.

FY 2007			
	Estimated FY07 Current Law	Estimated FY07 SF 128	Estimated Impact FY07
General Fund	\$ 89,500,000	\$ 68,597,104	\$ - 20,902,896
Health Care Trust Fund	\$ 0	\$ 53,580,435	\$ 53,580,435
Cigarette Tax Total	\$ 89,500,000	\$ 122,177,539	\$ 32,677,539

FY 2008			
	Estimated FY08 Current Law	Estimated FY08 SF 128	Estimated Impact FY08
General Fund	\$ 90,400,000	\$ 0	\$ - 90,400,000
Health Care Trust Fund	\$ 0	\$ 219,838,524	\$ 219,838,524
Cigarette Tax Total	\$ 90,400,000	\$ 219,838,524	\$ 129,438,524

FY 2009			
	Estimated FY09 Current Law	Estimated FY09 SF 128	Estimated Impact FY09
General Fund	\$ 89,500,000	\$ 0	\$ - 89,500,000
Health Care Trust Fund	\$ 0	\$ 223,508,669	\$ 223,508,669
Cigarette Tax Total	\$ 89,500,000	\$ 223,508,669	\$ 134,008,669

Tobacco Tax Impact:

Receipts from the tobacco tax will be split between the General Fund and the Health Care Trust Fund in FY 2007. In FY 2008 and FY 2009, all tobacco tax receipts will be deposited in the Health Care Trust Fund.

FY 2007			
	Estimated FY07 Current Law	Estimated FY07 SF 128	Estimated Impact FY07
General Fund	\$ 9,700,000	\$ 7,031,654	\$ - 2,668,346
Health Care Trust Fund	\$ 0	\$ 4,439,325	\$ 4,439,325
Tobacco Tax Total	\$ 9,700,000	\$ 11,470,979	\$ 1,770,979

FY 2008			
	Estimated FY08 Current Law	Estimated FY08 SF 128	Estimated Impact FY08
General Fund	\$ 10,000,000	\$ 0	\$ - 10,000,000
Health Care Trust Fund	\$ 0	\$ 14,885,748	\$ 14,885,748
Tobacco Tax Total	\$ 10,000,000	\$ 14,885,748	\$ 4,885,748

FY 2009			
	Estimated FY09 Current Law	Estimated FY09 SF 128	Estimated Impact FY09
General Fund	\$ 10,210,000	\$ 0	\$ - 10,210,000
Health Care Trust Fund	\$ 0	\$ 15,367,974	\$ 15,367,974
Tobacco Tax Total	\$ 10,210,000	\$ 15,367,974	\$ 5,157,974

Sales Tax Impact:

The estimated change in the State sales tax revenue will impact the General Fund. The amounts displayed for LOST and SILO represent statewide totals.

	FY07	FY08	FY09
Estimated Change in Sales Tax (General Fund Revenue)	\$ 849,030	\$ - 522,283	\$ - 411,300
Estimated Change in Local Option Sales Tax (LOST)	\$ 117,166	\$ - 72,075	\$ - 56,759
Estimated Change in School Infrastructure Local Option Sales Tax (SILO)	\$ 161,316	\$ - 99,234	\$ - 78,147

Overall General Fund Impact:

Based on the assumption noted above, starting April 1, 2007, revenues received from cigarette and tobacco taxes will be deposited in the Health Care Trust Fund rather than the General Fund. In addition, changes in the price and demand for cigarettes and tobacco will impact the sales tax revenues from the sales of cigarettes and tobacco. The table below provides the overall General Fund impact from the cigarette, tobacco and sales tax.

Estimated General Fund Impact			
	Estimated Change in General Fund FY07	Estimated Change in General Fund FY08	Estimated Change in General Fund FY09
Cigarette Tax Impact	\$ - 20,902,896	\$ - 90,400,000	\$ - 89,500,000
Tobacco Tax Impact	\$ - 2,668,346	\$ - 10,000,000	\$ - 10,210,000
Sales Tax Impact	\$ 849,030	\$ - 522,283	\$ - 411,300
Total G.F. Impact	\$ - 22,722,212	\$ - 100,922,283	\$ - 100,121,300

Overall Health Care Trust Fund Impact:

Estimated Health Care Trust Fund (HCTF) Impact			
	Estimated Health Care Trust Fund FY07	Estimated Health Care Trust Fund FY08	Estimated Health Care Trust Fund FY09
Cigarette Tax Impact	\$ 53,580,435	\$ 219,838,524	\$ 223,508,669
Tobacco Tax Impact	\$ 4,439,325	\$ 14,885,748	\$ 15,367,974
Total H.C.T.F. Impact	\$ 58,019,760	\$ 234,724,272	\$ 238,876,643

Sources

Iowa Department of Revenue
Revenue Estimating Conference Tax Receipt Projections
Campaign for Tobacco Free Kids, *State Cigarette Prices, Taxes, and Costs per Pack*
LSA Calculations

/s/ Holly M. Lyons

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The fiscal note and correctional impact statement for this bill was prepared pursuant to Joint Rule 17 and pursuant to Section 2.56, Code of Iowa. Data used in developing this fiscal note and correctional impact statement are available from the Fiscal Services Division, Legislative Services Agency to members of the Legislature upon request.
